

Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

CC:PSI:2 – PLR-104865-06

Date:

June 02, 2006

Legend

X:

Y:

A:

B:

Trust 1:

Trust 2:

Trust 3:

Trust 4:

Date 1:

Date 2:

Date 3:

Date 4:

Date 5:

PLR-104865-06

Dear _____ :

This responds to a letter dated January 17, 2006, and additional correspondence submitted on behalf of X by its authorized representative, requesting inadvertent termination relief under § 1362(f) of the Internal Revenue Code.

The information submitted states that X was incorporated in Date 1, and elected to be treated as an S corporation effective Date 2. On Date 3, pursuant to the terms of the A's Will, Trust 1 was funded with shares of X stock. However, the trust agreement for Trust 1 contained a provision that allowed the income beneficiary to designate a person other than herself to receive distributions of the principal of Trust 1. This provision prevented Trust 1 from satisfying all of the QSST requirements in § 1361(d)(3). Therefore, X's S election terminated on Date 3. Nonetheless, Trust 1 was administered at all times in a manner consistent with the requirements of a QSST under § 1361(d)(3) and has had only one income beneficiary. On Date 4, pursuant to the terms of B's Will, Trust 2, Trust 3 and Trust 4 were funded with shares of X stock (Trust 1, Trust 2, Trust 3 and Trust 4 are referred to collectively as the Trusts). Each Trust was intended to satisfy the requirements of a QSST as described in § 1361(d)(3). Additionally each of the current income beneficiaries of the Trusts failed to elect to treat its respective trust as a qualified subchapter S trust (QSST). On Date 5, Y acquired all of the issued and outstanding stock of X from its shareholders. In connection with the due diligence relative to the acquisition by Y of all of X's stock, the failure to file the QSST elections was discovered.

Each of the trust beneficiaries represent that his or her failure to file QSST elections was inadvertent and that the termination of X's S corporation status was not motivated by tax avoidance or retroactive tax planning. Additionally, X and the trust beneficiaries represent that they have filed federal income tax returns consistent both with the treatment of the Trusts as QSSTs effective as of the Trusts' respective dates of formation and X as an S corporation. X and each person who was a shareholder of X during the S corporation termination period agree to make any adjustments consistent with the treatment of X as an S corporation as may be required by the Secretary.

Section 1361(a)(1) provides that the term "S corporation" means, with respect to any taxable year, a small business corporation for which an election under § 1362(a) is in effect for such year.

Section 1361(b)(1)(B) provides that the term "small business corporation" means a domestic corporation which is not an ineligible corporation and which does not have as a shareholder a person (other than an estate, a trust described in § 1361(c)(2), or an organization described in § 1361(c)(6)) who is not an individual.

PLR-104865-06

Section 1361(c)(2)(A)(i) provides that for purposes of § 1361(b)(1)(B), a trust all of which is treated (under subpart E of part I of subchapter J of Chapter 1) as owned by an individual who is a citizen or resident of the United States may be a shareholder.

Section 1361(d)(1) provides that in the case of a QSST with respect to which a beneficiary makes an election under section 1361(d)(2)—(A) such trust shall be treated as a trust described in § 1361(c)(2)(A)(i) and, (B) for purposes of § 678(a), the beneficiary of such trust shall be treated as the owner of that portion of the trust which consists of stock in an S corporation with respect to which the election under § 1361(d)(2) is made.

Section 1361(d)(2)(A) provides that a beneficiary of a QSST (or his legal representative) may elect to have § 1361(d) apply. Section 1361(d)(2)(D) provides that an election under § 1361(d)(2) shall be effective up to 15 days and 2 months before the date of the election.

Section 1.1361-1(j)(6)(ii) of the Income Tax Regulations provides that the current income beneficiary of the trust must make the election under § 1361(d)(2) by signing and filing with the service center with which the corporation files its income tax return the applicable form or a statement including the information listed in § 1.1361-1(j)(6)(ii).

Section 1362(d)(2)(A) provides that an election under § 1362(a) will be terminated whenever (at any time on or after the 1st day of the 1st taxable year for which the corporation is an S corporation) such corporation ceases to be a small business corporation. Section 1362(d)(2)(B) provides that the termination shall be effective on and after the date of cessation.

Section 1362(f) provides that if—(1) an election under § 1362(a) by any corporation—(A) was not effective for the taxable year for which made (determined without regard to § 1362(b)(2)) by reason of a failure to meet the requirements of § 1361(b) or to obtain shareholder consents, or (B) was terminated under § 1362(d)(2) or (3), (2) the Secretary determines that the circumstances resulting in such ineffectiveness or termination were inadvertent, (3) no later than a reasonable period of time after discovery of the circumstances resulting in such ineffectiveness or termination, steps were taken—(A) so that the corporation is a small business corporation, or (B) to acquire the required shareholder consents, and (4) the corporation, and each person who was a shareholder in the corporation at any time during the period specified pursuant to § 1362(f), agrees to make such adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary with respect to such period, then, notwithstanding the circumstances resulting in such ineffectiveness or termination, such corporation shall be treated as an S corporation during the period specified by the Secretary.

PLR-104865-06

Based solely on the representations made and the information submitted, we conclude that X's S corporation election terminated on Date 3, under § 1362(d)(2), because the terms of Trust 1 failed to qualify Trust 1 as a QSST and the beneficiary of Trust 1 failed to file a QSST election, and that this termination of X's S election was an inadvertent termination within the meaning of § 1362(f). Accordingly, pursuant to the provisions of § 1362(f), X will be treated as continuing to be an S corporation from Date 3 through Date 5, provided X's S corporation election was valid and was not otherwise terminated under § 1362(d) (excluding the failure of the beneficiaries of Trust 2, Trust 3 and Trust 4 to file QSST elections). All of X's shareholders in determining their respective income tax liabilities during the termination period, must include their pro rata share of the separately stated items of income (including tax-exempt income), loss, deduction, or credit and nonseparately stated computed items of income or loss of X as provided in § 1366, make any adjustments to basis as provided in § 1367, and take into account any distributions made by X as provided in § 1368.

This ruling is conditioned upon the filing of a completed QSST election for each of the Trusts effective Date 3 or Date 4, as the case may be, with the appropriate service center within 60 days following the date of this letter. A copy of this letter should be attached to the QSST elections. If X or X's shareholders fail to treat X as described above, this ruling will be null and void.

Except as specifically set forth above, no opinion is expressed concerning the federal tax consequences of the facts described above under any other provision of the Code. Specifically, no opinion is expressed concerning whether X was or is a small business corporation or whether the Trusts are otherwise eligible to be QSSTs.

This ruling letter is directed only to the taxpayer who requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Pursuant to the power of attorney on file with this office, a copy of this letter is being sent to X's authorized representatives.

Sincerely,

J. Thomas Hines
Chief, Branch 2
Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosures (2)

Copy of this letter

Copy for § 6110 purposes